

Condensed Interim Consolidated Financial Statements

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2020 and 2019
(Unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Financial Position (unaudited)

(Expressed in thousands of Canadian dollars)

	Note	As at	
		September 30, 2020	March 31, 2020
Assets			
Current assets			
Cash and cash equivalents		162,594	169,141
Restricted short-term investments	7(b)	34,039	33,393
Other short-term investments		54,770	91,588
Trade and other receivables		23,199	19,488
Prepaid expenses		15,398	11,057
Inventories		36,677	31,897
Derivative assets	11	9	28
		326,686	356,592
Non-current assets			
Loan receivable		24,515	24,515
Property, plant and equipment	3	1,838,626	1,879,517
Intangible assets	4	99,525	99,893
		1,962,666	2,003,925
Total assets		2,289,352	2,360,517
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	5	101,928	132,296
Provisions		1,768	1,794
Interest payable on long-term debt	6	21,526	21,512
Contract liabilities		20,359	21,702
Current portion of long-term debt	6,7	15,302	21,644
Current portion of accrued employee future benefits		2,300	3,000
Current portion of lease liabilities	6	2,741	2,536
Derivative liabilities	11	13,883	15,507
		179,807	219,991
Non-current liabilities			
Accrued employee future benefits		20,796	20,151
Long-term debt	6,7	1,422,182	1,427,426
Lease liabilities	6	37,256	38,675
Other liabilities	9	10,340	10,962
Derivative liabilities	11	15,011	17,212
		1,505,585	1,514,426
Total liabilities		1,685,392	1,734,417
Equity			
Share capital		75,478	75,478
Contributed surplus		25,000	25,000
Retained earnings		523,576	547,745
Total equity before reserves		624,054	648,223
Reserves	12(a)	(20,094)	(22,123)
Total equity including reserves		603,960	626,100
Total liabilities and equity		2,289,352	2,360,517

Commitments (note 3)

Subsequent event (note 18)

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Profit or Loss and Other Comprehensive Income
(Loss) (unaudited)

(Expressed in thousands of Canadian dollars)

	Note	Three months ended		Six months ended	
		September 30		September 30	
		2020	2019	2020	2019
Revenue					
Vehicle and passenger fares		169,969	216,516	248,750	378,992
Net retail	13	8,381	23,869	9,164	40,666
Fuel (rebates) surcharges	17	(2,665)	2,981	(3,907)	3,820
Other income		2,566	3,532	3,609	6,569
Revenue from customers		178,251	246,898	257,616	430,047
Ferry service fees		61,388	74,579	111,416	129,988
Federal-Provincial Subsidy Agreement		8,007	7,835	16,014	15,670
Total revenue		247,646	329,312	385,046	575,705
Expenses					
Operations	14	126,803	152,231	232,124	292,919
Maintenance		15,162	13,440	38,243	39,752
Administration		8,837	9,271	20,080	17,967
Depreciation and amortization		44,498	45,740	88,546	90,462
Total operating expenses		195,300	220,682	378,993	441,100
Operating profit		52,346	108,630	6,053	134,605
Net finance and other expenses					
Finance expenses	15	15,436	15,330	30,542	30,321
Finance income		(1,062)	(1,508)	(2,284)	(2,681)
Net finance expense		14,374	13,822	28,258	27,640
Loss (gain) on disposal and revaluation of property, plant and equipment and intangible assets		105	(194)	1,964	(206)
Net finance and other expenses		14,479	13,628	30,222	27,434
NET EARNINGS (LOSS)		37,867	95,002	(24,169)	107,171
Other comprehensive income (loss)					
Items that are or may be reclassified subsequently to net earnings (loss)	12(b)	(5,147)	(3,832)	(5,543)	(3,890)
Items not to be reclassified to net earnings (loss)		(1,933)	(126)	(1,933)	(126)
Total other comprehensive loss		(7,080)	(3,958)	(7,476)	(4,016)
Total comprehensive income (loss)		30,787	91,044	(31,645)	103,155

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	Six months ended September 30	
	2020	2019
Operating activities		
Net (loss) earnings	(24,169)	107,171
Items not affecting cash:		
Net finance expense	28,258	27,640
Depreciation and amortization	88,546	90,462
Loss (gain) on disposal and revaluation of property, plant and equipment and intangible assets	1,964	(206)
Other non-cash changes to property, plant and equipment	119	(946)
Changes in:		
Accrued employee future benefits	(1,988)	(28)
Derivative assets and liabilities recognized in net loss	32	8
Provisions	(26)	3,367
Accrued financing costs	274	(434)
Total non-cash items	117,179	119,863
Movements in operating working capital:		
Trade and other receivables	(3,711)	(6,169)
Prepaid expenses	(4,341)	(5,721)
Inventories	(4,780)	(388)
Accounts payable and accrued liabilities	(30,368)	(34,759)
Contract liabilities	(1,343)	(6,837)
Change in non-cash working capital	(44,543)	(53,874)
Change in non-cash working capital attributable to investing activities	26,825	23,550
Change in non-cash operating working capital	(17,718)	(30,324)
Cash generated from operating activities	75,292	196,710
Interest received	1,905	3,276
Interest paid	(34,422)	(32,211)
Cash generated from operating activities	42,775	167,775

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	Six months ended September 30	
	2020	2019
Financing activities		
Repayment of long-term debt	(12,016)	(17,641)
Repayment of lease liabilities	(1,209)	(1,093)
Cash used in financing activities	(13,225)	(18,734)
Investing activities		
Proceeds from disposal of property, plant and equipment	94	295
Purchase of property, plant and equipment and intangible assets	(72,363)	(72,668)
Changes in restricted short-term investments	(646)	310
Net proceeds from (purchase of) other short-term investments	36,818	(1,969)
Cash used in investing activities	(36,097)	(74,032)
Net (decrease) increase in cash and cash equivalents	(6,547)	75,009
Cash and cash equivalents, beginning of period	169,141	59,888
Cash and cash equivalents, end of period	162,594	134,897

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Changes in Equity (unaudited)

(Expressed in thousands of Canadian dollars)

	Share capital	Contributed surplus	Retained earnings	Total equity before reserves	Reserves (note 12(a))	Total equity including reserves
Balance as at April 1, 2019	75,478	25,000	525,006	625,484	12,834	638,318
Net earnings	-	-	107,171	107,171	-	107,171
Other comprehensive loss	-	-	-	-	(4,016)	(4,016)
Realized hedge gains recognized in fuel swaps	-	-	-	-	(4,335)	(4,335)
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	124	124
Balance as at September 30, 2019	75,478	25,000	632,177	732,655	4,607	737,262
Balance as at April 1, 2020	75,478	25,000	547,745	648,223	(22,123)	626,100
Net loss	-	-	(24,169)	(24,169)	-	(24,169)
Other comprehensive loss	-	-	-	-	(7,476)	(7,476)
Realized hedge losses recognized in fuel swaps	-	-	-	-	9,381	9,381
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	124	124
Balance as at September 30, 2020	75,478	25,000	523,576	624,054	(20,094)	603,960

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

British Columbia Ferry Services Inc. (the "Company") was incorporated under the Company Act (British Columbia) by way of conversion on April 2, 2003, and now validly exists under the Business Corporations Act (British Columbia). The Company's primary business activity is the provision of coastal ferry services in British Columbia.

The Company is subject to the Coastal Ferry Act (the "Act") as amended, which originally came into force on April 1, 2003. Its common share is held by the B.C. Ferry Authority (the "Authority"), a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the "Commissioner") to ensure that rates are fair and reasonable and to monitor service levels.

On March 11, 2020, the World Health Organization declared the outbreak of novel coronavirus ("COVID-19") as a pandemic. The preventative measures and imposed travel restrictions significantly impacted the Company's earnings and cash from operations during the six months ended September 30, 2020.

Historically, the Company's business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference for travel during the summer months. The Company also takes advantage of the low activity during the winter months to perform a significant portion of the required annual maintenance on vessels and at terminals. However, given the impact of the COVID-19 pandemic, it is expected that the normal seasonal demand pattern will not occur during fiscal 2021, with certain revenues, expenses, and balance sheet items tied directly to sales and operating activities expected to be significantly impacted by the drop in vehicle and passenger traffic.

The Company is actively monitoring the situation to ensure the transportation of essential goods and services, adjusting service levels by following the directives and guidance provided by the Province of British Columbia ("the Province") and Transport Canada, adhering to provincial and federal guidelines and putting preventative measures in place to protect passengers and employees aboard the vessels, terminals and in all workplaces, while managing to preserve cash and protect the financial well-being of the Company.

1. Accounting policies:

(a) Reporting entity:

British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company's registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These condensed interim consolidated financial statements, as at and for the six months ended September 30, 2020 and 2019, comprise the Company and its subsidiaries (together referred to as the "Group").

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

1. Accounting policies:

(b) Basis of preparation:

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and its interpretations and comply with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*. These condensed interim consolidated financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Company's last annual consolidated financial statements as at and for the year ended March 31, 2020, as they follow the same accounting policies.

These condensed interim consolidated financial statements have been prepared using the historical cost method, except for items that IFRS permits to be measured at fair value - owned land, head office land under lease and certain financial assets and liabilities including derivatives.

These condensed interim consolidated financial statements are presented in Canadian dollars ("CAD") which is the Group's functional currency. All tabular financial data is presented in Canadian dollars and rounded to the nearest thousand, unless otherwise stated.

These condensed interim consolidated financial statements were approved by the Board of Directors on November 19, 2020.

2. Adoption of new and amended standards:

(a) Changes in accounting policies:

The Group did not adopt any new or amended standards during the six months ended September 30, 2020.

(b) Future changes in accounting policies:

IFRS 17, Insurance Contracts:

In May 2017, the International Accounting Standards Board ("IASB") issued IFRS 17, *Insurance Contracts*, which will replace IFRS 4, *Insurance Contracts*. On June 26, 2019, the IASB issued an exposure draft covering targeted amendments to IFRS 17, including a proposed amendment to defer the effective date of the Standard by one year to January 1, 2022.

On March 17, 2020, the IASB decided, due to the responses received from stakeholders during the comment period on the exposure draft, that the effective date of the Standard will be deferred to annual reporting periods beginning on or after January 1, 2023.

In June 2020, the IASB issued *Amendments to IFRS 17*. The objective of the amendments is to assist entities implementing the Standard, while not unduly disrupting implementation or diminishing the usefulness of the information provided by applying IFRS 17. The Group will continue to evaluate the potential impact on its consolidated financial statements as further information becomes available.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment:

	Vessels	Berths, buildings and equipment	Right-of-use assets – Berths, buildings and equipment	Right-of-use assets - Land	Land	Construction in progress	Total
Cost:							
Balance as at March 31, 2020	1,769,775	679,386	174,721	42,538	29,665	200,013	2,896,098
Additions	(622) ¹	-	-	-	-	41,700	41,078
Disposals	(10,613)	(1,087)	(30)	(5)	-	(1,973)	(13,708)
Transfers from construction in progress	60,990	7,841	-	-	-	(68,831)	-
Balance as at September 30, 2020	1,819,530	686,140	174,691	42,533	29,665	170,909	2,923,468
Accumulated depreciation:							
Balance as at March 31, 2020	705,645	235,590	74,051	1,295	-	-	1,016,581
Depreciation	59,069	17,220	3,407	281	-	-	79,977
Disposals	(10,613)	(1,073)	(30)	-	-	-	(11,716)
Balance as at September 30, 2020	754,101	251,737	77,428	1,576	-	-	1,084,842
Net carrying value:							
As at March 31, 2020	1,064,130	443,796	100,670	41,243	29,665	200,013	1,879,517
As at September 30, 2020	1,065,429	434,403	97,263	40,957	29,665	170,909	1,838,626

¹ Reclassifications from Other liabilities (note 7)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment (continued):

During the six months ended September 30, 2020, financing costs capitalized during construction amounted to \$4.0 million (September 30, 2019: \$1.8 million) with an average capitalization rate of 4.58% (September 30, 2019: 4.99%).

Contractual commitments as at September 30, 2020, for assets to be constructed totalled \$99.4 million (March 31, 2020: \$121.5 million). The majority of these contractual commitments relate to the construction of four Island class vessels and one Salish class vessel.

During the six months ended September 30, 2020, the Group recognized property, plant and equipment impairments of \$2.0 million (March 31, 2020: \$nil). The impairment loss is reported under "Loss (gain) on disposal and revaluation of property, plant and equipment and intangible assets" in the consolidated statement of profit or loss for the six months ended September 30, 2020.

The Government of Canada, through the New Building Canada Fund, agreed to provide funding of up to \$43.4 million to help offset the costs of the newly established route connecting Port Hardy and Bella Coola and the replacement of two minor vessels. During the six months ended September 30, 2020, the Group recognized \$0.2 million (March 31, 2020: \$9.7 million) as a reduction of the cost of property, plant and equipment. Funding of \$39.5 million was recorded as a cumulative reduction of the cost of the property, plant and equipment in fiscal years 2020, 2019 and 2018.

FortisBC Energy Inc. has committed to provide the Group with funding as part of the Natural Gas for Transportation ("NGT") incentive funding. The contributions are dependent upon the purchase of liquefied natural gas ("LNG"). During the six months ended September 30, 2020, the Group recognized \$0.6 million (March 31, 2020: \$1.2 million) as a reduction of the cost of property, plant and equipment.

During the six months ended September 30, 2020, the Group received \$0.1 million (September 30, 2019: \$0.5 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated depreciation of \$11.9 million and \$4.2 million, respectively, as at September 30, 2020.

During the six months ended September 30, 2020, the *North Island Princess* and the *Nimpkish* were decommissioned and sold. The *Queen of Burnaby* (decommissioned during the year ended March 31, 2018) is classified as held for sale and has no carrying value.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

4. Intangible assets:

	Acquired software, licenses and rights	Internally developed software and website	Assets under development	Total
Cost:				
Balance as at March 31, 2020	137,877	19,898	29,469	187,244
Additions	-	-	8,201	8,201
Transfers from construction in progress	2,201	23,251	(25,452)	-
Balance as at September 30, 2020	140,078	43,149	12,218	195,445
Accumulated amortization:				
Balance as at March 31, 2020	74,425	12,926	-	87,351
Amortization	7,784	785	-	8,569
Balance as at September 30, 2020	82,209	13,711	-	95,920
Net carrying value:				
As at March 31, 2020	63,452	6,972	29,469	99,893
As at September 30, 2020	57,869	29,438	12,218	99,525

Capitalized financing costs during construction for intangible assets with an average capitalization rate of 4.58% (September 30, 2019: 4.99%) for the six months ended September 30, 2020 totalled \$0.6 million (September 30, 2019: \$0.5 million).

During the six months ended September 30, 2020, intangible assets totalling \$5.2 million (September 30, 2019: \$4.8 million) were acquired and \$3.0 million (September 30, 2019: \$3.7 million) were internally developed.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

5. Accounts payable and accrued liabilities:

Wages payable consists of contractual liabilities to employees for deferred or accrued compensation. Liabilities for deferred compensation amounts are generally settled through either payment or provision of paid time off.

	As at	
	September 30, 2020	March 31, 2020
Trade payable and accrued liabilities	34,311	62,551
Wages payable	67,617	69,745
Accounts payable and accrued liabilities	101,928	132,296

6. Liabilities arising from financing activities:

Continuity of liabilities arising from financing activities:

	Long-term debt	Lease liabilities ¹	Interest payable on long-term debt
Balance as at March 31, 2020	1,449,070	41,211	21,512
Additions	-	-	33,356
Disposals	-	(5)	-
Payments	(12,016)	(1,209)	(33,342)
Amortization of debt issue costs	430	-	-
Balance as at September 30, 2020	1,437,484	39,997	21,526
Current	15,302	2,741	21,526
Non-current	1,422,182	37,256	-
Balance as at September 30, 2020	1,437,484	39,997	21,526

¹ Interest expense related to lease liabilities is presented in net finance expense (note 15).

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

7. Long-term debt:

	As at	
	September 30, 2020	March 31, 2020
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate of 6.41%)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate of 5.06%)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate of 5.62%)	200,000	200,000
4.70% Senior Secured Bonds, Series 13-1, due October 2043 (effective interest rate of 4.75%)	200,000	200,000
4.29% Senior Secured Bonds, Series 14-1, due April 2044 (effective interest rate of 4.45%)	200,000	200,000
2.79% Senior Secured Bonds, Series 19-1, due October 2049 (effective interest rate of 2.83%)	250,000	250,000
12 Year Loan, maturing June 2020 Tranche A (effective interest rate of 5.18%)	-	1,875
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	4,500	9,000
2.09% Loan, maturing October 2028 (effective interest rate of 2.70%)	30,830	32,699
2.09% Loan, maturing January 2029 (effective interest rate of 2.68%)	32,052	33,938
2.09% Loan, maturing January 2029 (effective interest rate of 2.70%)	32,052	33,938
	1,449,434	1,461,450
Less: Unamortized deferred financing costs and bond discounts	(11,950)	(12,380)
Total	1,437,484	1,449,070
Current	15,302	21,644
Non-current	1,422,182	1,427,426
Total	1,437,484	1,449,070

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

7. Long-term debt (continued):

The Group has six outstanding series of obligation bonds and a credit facility agreement secured by pledged bonds. In addition, the Group has a 2.95% loan agreement and three 2.09% loans outstanding with KfW IPEX-Bank GmbH ("KfW"), a German export credit bank.

(a) Credit facility:

The Group has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of \$155.0 million, was renewed on April 8, 2020 to extend the maturity date to April 20, 2025. There were no draws on this credit facility as at September 30, 2020 or March 31, 2020. There was no interest expensed during the six months ended September 30, 2020 and September 30, 2019. Letters of credit outstanding against this facility as at September 30, 2020 totalled \$0.6 million (March 31, 2020: \$0.6 million).

(b) Debt service reserves:

Long-term debt agreements require the Group to maintain debt service reserves equal to a minimum of six months of interest payments. In the event that the debt service coverage ratio is less than 1.50, the Group is required to increase the amount in the debt service reserves to an amount equal to 12 months of interest payments no later than 12 months after the occurrence of such event.

As at September 30, 2020, the debt service coverage ratio of 1.46 triggered the requirement to increase the debt service reserves to an amount equal to 12 months of interest payments.

As at September 30, 2020, debt service reserves of \$34.0 million (March 31, 2020: \$33.4 million) were held in short-term investments and have been classified as restricted short-term investments on the statement of financial position.

(c) Debt service coverage:

Debt service coverage (earnings before interest, taxes, depreciation, amortization and rent) is required to be at least 1.25 times the debt service cost under the credit facility agreement and KfW loans.

On May 15, 2020, the Group's banking syndicate approved an Amendment to the Credit Facility Agreement whereby the debt service coverage of the impacted quarters in fiscal 2021 (first, second and third) is replaced by an average of the debt service coverage from the respective quarters in fiscal years 2018, 2019 and 2020. As at September 30, 2020, the debt service coverage ratio calculated under this method was 2.71.

On June 19, 2020, KfW waived the debt service coverage covenant until and including March 2021.

As a condition for both the credit facility agreement and the KfW loans, for the duration of the relief period, the Group is required to maintain \$50.0 million in unrestricted cash, which can be comprised of cash, short-term investments, and undrawn credit facility.

In addition, there are other covenants contained in the Master Trust Indenture (May 2004) available at www.SEDAR.com. The Group was in compliance with all of its covenants at September 30, 2020 and at March 31, 2020.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

8. Accrued employee future benefits:

During the six months ended September 30, 2020, the Group recognized total defined benefit costs of \$1.3 million (September 30, 2019: \$1.1 million).

During the three months ended September 30, 2020, the Group recognized a loss of \$1.9 million in other comprehensive income reflecting the actuarial valuation for the retirement and death defined benefit plans as at March 31, 2020.

During the three months ended September 30, 2019, the Group recognized a loss of \$0.1 million in other comprehensive income reflecting an actuarial valuation for the residual liability for Worker's Compensation Claims arising from the Worker's Compensation Board deposit coverage system as at March 31, 2019.

9. Other liabilities:

FortisBC Energy Inc. has committed to provide the Group with funding of \$6.0 million for the Salish Class vessels and up to \$10.0 million for the two Spirit Class vessels to be applied towards their mid-life upgrade and conversion to LNG. The funding is part of the NGT incentive funding and is dependent upon the purchase of LNG and the incremental costs of building/converting vessels to be capable of using LNG for propulsion.

As of March 31, 2020, the Group had received \$7.0 million of the total eligible contributions related to the Spirit class vessels, and all of the eligible contributions related to the Salish Class vessels.

During the six months ended September 30, 2020, the Group recognized \$0.6 million (March 31, 2020: \$1.2 million) as an offset to the capital costs of the vessels.

	Note	Salish Class	Spirit Class	Total
Balance as at March 31, 2020		4,975	5,987	10,962
Reclassifications to property, plant and equipment	3	(205)	(417)	(622)
Balance as at September 30, 2020		4,770	5,570	10,340

10. Financial instruments:

The carrying values of the Group's financial instruments approximate fair value as at September 30, 2020 and March 31, 2020 for all financial instruments except for long-term debt.

	As at September 30, 2020		As at March 31, 2020	
	Carrying Value	Approx Fair Value	Carrying Value	Approx Fair Value
Long-term debt, including current portion ¹	1,437,484	1,875,136	1,449,070	1,758,082

¹ Classified in Level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets (derived from prices).

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

10. Financial instruments:

Carrying value is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at the date of the statements of financial position, or by using available quoted market prices.

The following items shown in the consolidated statements of financial position as at September 30, 2020 and March 31, 2020 are carried at fair value on a recurring basis using Level 1 or 2 inputs. There were no financial assets and liabilities at September 30, 2020, or at March 31, 2020, valued using Level 3 inputs.

	As at September 30, 2020		As at March 31, 2020	
	Level 1	Level 2	Level 1	Level 2
Asset (liability):				
Cash ^{1,2}	154,424	-	140,703	-
Cash equivalents ²	138	-	138	-
Derivative assets ³	-	9	-	28
Derivative liabilities ³	-	(28,894)	-	(32,719)
	154,562	(28,885)	140,841	(32,691)

¹ Excluding Cash and cash equivalents of \$8.0 million (March 31, 2020: \$28.3 million) held at amortized cost.

² Classified in Level 1 as the measurement inputs are derived from observable, unadjusted quoted prices in active markets for identical assets.

³ Classified in Level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets (derived from prices).

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where market prices are not available, fair values are estimated using discounted cash flow analysis. No amounts have been reclassified into or out of fair value classifications in the six months ended September 30, 2020.

During the six months ended September 30, 2020, gains or losses related to Level 2 derivatives have been recorded in other comprehensive income ("OCI").

There were no Level 3 instruments outstanding during the period.

The Group may use derivative instruments to hedge its exposure to fluctuations in fuel prices, interest rates and foreign currency exchange rates. The fair value of commodity derivatives reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that the Group would receive or pay should the derivative contracts be terminated at the period end dates.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

11. Financial risk management:

(a) Credit risk:

The Group is using the lifetime expected credit loss (“ECL”) simplified approach as the method to determine the provision for impairment. The Group reviews for changes in circumstances at each reporting date.

Based on the historical default experience, the Group has established a lifetime ECL allowance of 1% of the trade receivables. Amounts due from the Government of Canada and the Province are considered low credit risk and are excluded. As at September 30, 2020, the provision for impairment was \$0.1 million.

Based on historical default experience, financial position of the counterparties and estimating the probability of default, the lifetime ECL equals zero for the Group’s restricted and other short-term investments.

The Group has a loan receivable with a term of 15 years, secured by a second mortgage. The collateral is expected to exceed the amount of the loan and be available while the loan is outstanding.

(b) Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel fuel and LNG fuel. In order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices, the Group may manage its exposure by entering into hedging instruments with certain financial intermediaries. Fuel price hedging instruments are used to reduce fuel price risk and to minimize fuel surcharges, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. The Group’s Financial Risk Management Policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption for the 12 month period thereafter; 85% of anticipated monthly fuel consumption for the period thereafter to the end of 36 month period; and to 70% of anticipated monthly fuel consumption for the period between 36 months and the end of the fifth performance term. Performance term five commenced April 1, 2020 and will end on March 31, 2024.

The Group is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its regulatory (non-IFRS) earnings (note 17).

The Group hedges using CAD denominated ultra-low sulfur diesel (“ULSD”) fuel swaps to reduce its exposure to changes in ULSD and foreign exchange risk components associated with forecast diesel fuel purchases. No ULSD fuel swap contracts were entered into during the six months ended September 30, 2020. The notional value of all fuel swap contracts outstanding as at September 30, 2020 was \$107.8 million (March 31, 2020: \$132.2 million). Hedge accounting was applied to these contracts. No LNG swap contracts were entered into during the six months ended September 30, 2020 and no LNG swap contracts were outstanding as at September 30, 2020.

An economic relationship exists between the hedged item and the hedging instrument as the value of the hedging instrument and the value of the hedged item move in the opposite direction as a result of the change in the hedged risk. A change in the credit risk of the hedging instrument or the hedged item does not dominate the value changes that result from the economic relationship.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

11. Financial risk management (continued):

(b) Fuel price risk (continued):

During the six months ended September 30, 2020, open fuel swap contracts had unrealized hedging losses of \$5.5 million recognized in OCI (September 30, 2019: unrealized hedging losses of \$3.9 million). In addition, for closed fuel swap contracts net realized hedging losses of \$9.4 million were reclassified from reserves and included in the Group's fuel expense during the six months ended September 30, 2020 (September 30, 2019: net realized hedging gains of \$4.3 million).

Due to the drastic reduction in fuel consumption as a result of COVID-19, the Group determined that the hedged amounts related to one of the Group's contracts for the three months ended June 30, 2020 were no longer considered highly probable to occur and the Group discontinued hedge accounting for this contract effective March 31, 2020. The hedging loss related to this contract was included within the \$9.4 million of fuel swap contract losses recognized in the consolidated statement of profit or loss for the six months ended September 30, 2020.

Cash flow hedges:

	Fiscal 2021	Fiscal 2022	Fiscals 2023-2024	Total
Fuel contracts (litres in thousands)	29,590	63,490	78,175	171,255
Contract price range (\$/litre)	\$0.5990-\$0.6520	\$0.6270-\$0.6499	\$0.6090-\$0.6336	

The impact of hedging instruments designated in hedging relationships as of September 30, 2020 on the statements of financial position was as follows:

	Notional amount	Carrying amount	Line item in the statement of financial position	Change in fair value used for measuring ineffectiveness for the period
Fuel swap contracts	42,144	(13,871)	Current derivative liabilities	(13,871)
Fuel swap contracts	65,705	(15,011)	Non-current derivative liabilities	(15,011)
Foreign exchange forward contracts	468	9	Current derivative assets	9
Foreign exchange forward contracts	403	(12)	Current derivative liabilities	(12)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

11. Financial risk management (continued):

(b) Fuel price risk (continued):

Cash flow hedges (continued):

The impact of hedged items designated in hedging relationships as of September 30, 2020 on the statements of financial position was as follows:

	Change in value used for measuring ineffectiveness	Cash flow hedge reserve
Fuel swap contracts	28,961	28,882

Cash flow hedge reserve (note 12(a)):

	Three months ended September 30		Six months ended September 30	
	2020	2019	2020	2019
Hedging losses recognized in cash flow hedge reserve:				
Fuel swap contracts	(5,147)	(3,832)	(5,543)	(3,890)
Hedging losses (gains) reclassified from cash flow hedge reserve:				
Interest rate forward contracts – Amortization of hedge loss	62	63	124	124
Fuel swap contracts – Losses (gains) recognized in net earnings	4,559	(1,378)	9,381	(4,335)
Net change in cash flow hedge reserve	(526)	(5,147)	3,962	(8,101)

12. Other comprehensive loss:

(a) Continuity of reserves:

	Note	Land revaluation reserves	Employee future benefit revaluation reserves	Fuel swap reserves	Interest rate forward contract reserves	Total
Balance as at March 31, 2020		22,658	(6,095)	(32,720)	(5,966)	(22,123)
Actuarial losses on post-employment benefit obligations:	8	-	(1,933)	-	-	(1,933)
Derivatives designated as cash flow hedges:	11					
Net change in fair value		-	-	(5,543)	-	(5,543)
Realized losses		-	-	9,381	-	9,381
Amortization of losses		-	-	-	124	124
Balance as at September 30, 2020		22,658	(8,028)	(28,882)	(5,842)	(20,094)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

12. Other comprehensive loss (continued):

(b) Other comprehensive loss:

	Note	Three months ended September 30		Six months ended September 30	
		2020	2019	2020	2019
Items that are or may be reclassified subsequently to net earnings:					
Hedge losses on fuel swaps	11	(5,147)	(3,832)	(5,543)	(3,890)
Items that will not be reclassified to net earnings:					
Actuarial losses on post-employment benefit obligations	8	(1,933)	(126)	(1,933)	(126)
		(7,080)	(3,958)	(7,476)	(4,016)

13. Net retail:

	Three months ended September 30		Six months ended September 30	
	2020	2019	2020	2019
Retail revenue	13,425	37,597	14,747	64,622
Cost of goods sold	(5,044)	(13,728)	(5,583)	(23,956)
Net retail	8,381	23,869	9,164	40,666

14. Operating expenses:

	Three months ended September 30		Six months ended September 30	
	2020	2019	2020	2019
Salaries, wages & benefits	96,289	106,966	186,255	214,300
Fuel	26,166	32,808	44,507	59,781
Materials, supplies and contracted services	17,665	19,651	36,373	44,995
Other operating expenses	10,682	15,517	23,312	31,562
Depreciation and amortization	44,498	45,740	88,546	90,462
Total operating expenses	195,300	220,682	378,993	441,100

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

15. Net finance expense:

	Three months ended		Six months ended	
	September 30		September 30	
	2020	2019	2020	2019
Finance expenses:				
Long-term debt	16,739	15,527	33,394	30,983
Short-term debt	45	47	166	110
Lease liabilities	454	477	916	984
Amortization of deferred financing costs and bond discounts	341	286	619	574
Interest capitalized in the cost of qualifying assets	(2,143)	(1,007)	(4,553)	(2,330)
Total finance expenses	15,436	15,330	30,542	30,321
Finance income	(1,062)	(1,508)	(2,284)	(2,681)
Net finance expense	14,374	13,822	28,258	27,640

16. Related party transactions:

In accordance with the Act, the Group is responsible for paying any expenses that are incurred by the Authority, without charge. During the six months ended September 30, 2020, the Group paid \$86,639 (September 30, 2019: \$134,479) of such expenses.

The Province owns the Group's 75,477 non-voting preferred shares, but has no voting interest in either the Group or the Authority.

17. Economic effect of rate regulation:

The Group is regulated by the Commissioner to ensure, among other things, that tariffs are fair and reasonable. Under the terms of the Act, the tariffs the Group charges its customers are subject to price caps. The Commissioner may, in extraordinary situations, allow increases in price caps over the set levels.

In January 2014, the IASB issued IFRS 14, *Regulatory Deferral Accounts*. IFRS 14 is an interim standard, pending the outcome of IASB's more comprehensive rate regulated activities project.

The Standard addresses the accounting for regulatory deferral accounts; however, it does not allow the recognition of regulatory assets and regulatory liabilities that result from the regulated price cap setting process for entities, such as the Group, that had already transitioned to IFRS. The Group transitioned to IFRS effective April 1, 2011, prior to the issuance of IFRS 14, and therefore does not recognize regulatory assets or liabilities.

As a result, the Group is not permitted to recognize its regulatory assets and regulatory liabilities in its consolidated statements of financial position.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

17. Economic effect of rate regulation (continued):

Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes that the obligations represented by the regulatory liabilities at September 30, 2020, will be settled through future tariff reductions or fuel rebates.

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At September 30, 2020 and March 31, 2020, tariffs charged to customers were below established price caps.

If the Group was permitted under IFRS to recognize the effects of rate regulation, the regulatory liabilities at September 30, 2020 would have been \$1.0 million (March 31, 2020: \$2.1 million).

If the Group was permitted under IFRS to recognize the effects of rate regulation and to record regulatory assets and regulatory liabilities, net earnings for the three months ended September 30, 2020 would have been \$0.3 million higher (September 30, 2019: 4.2 million lower), and during the six months ended September 30, 2020 would have been \$1.1 million higher (September 30, 2019: \$6.0 million lower) as detailed below:

	Three months ended		Six months ended	
	September 30		September 30	
Effect of rate regulation on net earnings	2020	2019	2020	2019
Regulatory accounts:				
Deferred fuel costs:				
Fuel costs under set price	(2,381)	(1,261)	(2,792)	(2,198)
Rebates (surcharges)	2,665	(2,981)	3,907	(3,820)
Total increase (decrease) in net earnings	284	(4,242)	1,115	(6,018)

18. Subsequent event:

During November 2020, the Group reached a formal agreement with the Province regarding the Safe Restart Funding Program and will receive \$308.0 million. As of the date of these financial statements, the funds have not been received and the timing of receipt and recognition within the financial statements is currently under review.